VZCZCXRO0302
PP RUEHDU RUEHMR RUEHRN
DE RUEHSB #1134/01 3550905
ZNY CCCCC ZZH
P 210905Z DEC 07 ZDK MESSAGE TOOK HITS AND WAS NOT COMPLETE
FM AMEMBASSY HARARE
TO RUEHC/SECSTATE WASHDC PRIORITY 2339
INFO RUCNSAD/SOUTHERN AFRICAN DEVELOPMENT COMMUNITY
RUEHUJA/AMEMBASSY ABUJA 1805
RUEHAR/AMEMBASSY ACCRA 1702
RUEHDS/AMEMBASSY ADDIS ABABA 1830
RUEHBY/AMEMBASSY CANBERRA 1107
RUEHDK/AMEMBASSY DAKAR 1464
RUEHKM/AMEMBASSY KAMPALA 1886
RUEHNR/AMEMBASSY NAIROBI 4314
RUEHGV/USMISSION GENEVA 0957
RHEHAAA/NSC WASHDC
RHMFISS/JOINT STAFF WASHDC
RUEHC/DEPT OF LABOR WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RHEFDIA/DIA WASHDC//DHO-7//
RUCPDOC/DEPT OF COMMERCE WASHDC
RUFOADA/JAC MOLESWORTH RAF MOLESWORTH UK//DOOC/ECMO/CC/DAO/DOB/DOI//
RUEPGBA/CDR USEUCOM INTEL VAIHINGEN GE//ECJ23-CH/ECJ5M//

C O N F I D E N T I A L SECTION 01 OF 04 HARARE 001134

SIPDIS

SIPDIS

AF/S FOR S. HILL
NSC FOR SENIOR AFRICA DIRECTOR B. PITTMAN
STATE PASS TO USAID FOR L.DOBBINS AND E.LOKEN
TREASURY FOR J. RALYEA AND T.RAND
COMMERCE FOR BECKY ERKUL
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS

E.O. 12958: DECL: 11/21/2017
TAGS: ECON EFIN PGOV ZI
SUBJECT: GONO DODGES EFFECTIVE REFORM IN SIMPLY ISSUING NEW
NOTES

REF: A. HARARE 01042
¶B. HARARE 0118
¶C. HARARE 0951

HARARE 00001134 001.2 OF 004

Classified By: Pol/Econ Deputy Chief Frances Chisholm. Reason: 1.4 (d
)

Summary

¶1. (C) Reserve Bank of Zimbabwe (RBZ) Governor Gono announced the issuance of new, higher-denominated bearer cheques on December 19, 2007 and the withdrawal of the previously largest note as a move against cash hoarders. He did not remove any zeros from the currency. Two days later, Zimbabwe is still in a cash crisis as the RBZ fails to meet the banks' cash requirements which are soaring in lockstep with six-digit inflation. Gono also announced earlier this month higher statutory reserve requirements on banks and higher accommodation rates, which have the effect of squeezing banks' lending capacity and their profitability at the same time that they are forced to compete with the RBZ for corporate clients. In the face of hyperinflation, the banks are seeking creative ways to make money but their deposit base is eroding in real terms. Bankers doubt whether Gono's latest move will resolve the cash shortage and draw depositors back into the formal banking system. Yet again, he has failed to address the economy's fundamental distortions. End Summary.

Gono Introduces New Notes, Leaves Zeros

¶2. (U) RBZ Governor Gono attempted to remedy Zimbabwe's deepening cash shortage crisis on December 19, 2007 with the announcement of the following changes:

-- The Z$200,000 bearer cheque will cease to be legal tender on January 1, 2008. (Note: This note was the highest denomination in circulation; it has a value of about 11 US cents on the parallel cash market and about US 3 cents on the parallel market for bank transfers. End Note)
-- Deposit limits with no questions asked are Z$50 million for individuals and Z$750 million for companies.
-- New bearer cheques of Z$250,000, Z$500,000, and Z$750,000 will be issued on December 21, 2007.
-- The daily withdrawal limit will be raised from Z$20 million to Z$50 million for individuals.
-- To ensure a smooth transition, banks will remain open throughout the pre-Christmas weekend.
-- There will be no "slashing of zeros." (Note: Questioned as to how systems would handle the mounting zeros in the months ahead, Gono told bankers earlier in the week to "find a way," even if it meant "going back to manual." End Note)

The "Cash Baron" Bogeyman

¶3. (U) Gono defended the withdrawal of the 200,000 Zimbabwe dollar note from the market as a measure to bring down "a web of cash barons," who, he said, had been hoarding that note in particular, and causing the cash shortage. Among the hoarders were "businesses, wholesalers, retailers,

politicians, politicians and politicians, bankers, smugglers and fuel companies." He said he was prepared to name the hoarders, but only before a parliamentary committee. In his televised address, he also maintained that the slashing of three zeros in August 2006 had ignited a sharp rise in prices and would not be repeated.

Still Chaos in the Cash Market

¶4. (C) Two days after the announcement, the cash market is still chaotic as the RBZ fails to supply banks with enough cash to meet demand. Lines at banks are longer than ever (Refs A and B) as customers wait for deliveries of cash. ZB Bank, for example, told us that on December 20 they had ordered Z$3 trillion cash from the RBZ but were promised only Z$200 billion, which they got entirely in soon-to-expire Z$200,000 notes.

¶5. (SBU) Ordinary Zimbabweans are lingering at supermarket tills, seeking any opportunity to pay for a stranger's groceries by debit card, keeping the other shopper's cash. In the seventh week of the cash crisis, some restaurants are offering diners a 30 percent discount for payment in cash, or charging as much as double the price for payment by check, and vendors are increasingly accepting the greenback at very favorable rates.

--- --------
Higher Statutory Reserve Requirements Squeeze Lending
--- --------

¶6. (SBU) Amid the cash crisis and money supply growth that was 17,073.1 percent in August 2007, the RBZ increased statutory reserve requirements for financial institutions from 45 percent to 50 percent for demand deposits and from 35 percent to 45 percent for time deposits on December 7, 2007. Simba Mabhena, Head of Global Markets at Standard Chartered

Bank, explained to econoff on December 13 that the policy shift reduced the amount of funds available to the banks for on-lending and, as a consequence, reduced bank revenue.

--- -
And Higher Accommodation Rates Squeeze Margins
--- -

¶7. (C) The RBZ also raised its accommodation rate from 850 percent for secured borrowings to 975 percent and from 900 percent for unsecured borrowings to 1,100 percent with effect from December 7, 2007. (Note: The accommodation rate is the overnight rate at which banks borrow from the RBZ when they are short on any one day. End Note) Mabhena said that the overall market position of the banks was Z$17 trillion shrt on December 10 and Z$8.5 trillion on December13, forcing banks to borrow huge sums overnight at the prohibitive rate, which was eating into their profitability. Mabhena said it was assumed in the banking sector that the RBZ was using the overnight funds plus the statutory reserves to finance its quasi-fiscal concessionary loan facilities.

How The Banks Are Surviving, For Now

¶8. (C) Mabhena complained that the commercial banks were

suffering from competition from the RBZ,s Basic Commodities Supply-Side Intervention Facility (BACOSSI)(Ref C) and Agricultural Sector Productivity Enhancement Facility (ASPEF). Mabhena said BACOSSI had drawn the banks "completely out of the corporate lending market," a view corroborated by Francis Macheka, Head of banking at Agribank, who told us that most borrowers had substituted BACOSSI and ASPEF for their usual commercial borrowings, resulting in a squeeze on margins. Nevertheless, Agribank was able to make money with top-up loans at commercial rates to those clients with a higher appetite for funding than BACOSSI could satisfy. Chitumba, for his part, said the crowding out of the commercial banks by the RBZ was "not significant" for Stanbic. The stringent BACOSSI terms and high degree of scrutiny by the RBZ had left a window open for banks to lend even at the current commercial rate of 300 percent interest. With inflation at around 100,000 percent by private sector accounts, 300 percent interest was attractive. Furthermore, since the bank paid practically no interest on deposits, Chitumba said Stanbic was still able to earn a decent margin on its lending.

¶9. (C) Fulton Chibaya, CEO of Genesis Investment Bank, told economic specialist on December 17 that banks with asset management divisions were able to make money by buying assets on the bull Zimbabwe Stock Exchange. Under the current hyperinflationary environment, most financial institutions undertake "fair value adjustments" and record the unrealized profits in their books. Some banks that are not engaged in asset management are keeping afloat on margins earned on the interest rate differentials of Treasury bills that they buy and sell, while others engage in foreign currency trading.

--- -------
Potential Erosion of Deposit Base Due to Cash Crisis
--- -------

¶10. (C) On the current cash shortage, Mabhena and Chitumba both agreed that the banks faced loss of customer confidence and the erosion of their deposit base in real terms as customers increasingly hold their cash outside the formal banking system. Chitumba, however, pointed out that while cash deposits had dried up since the shortage began, deposits by electronic transfer and check at Stanbic had grown 30-50 percent and were a new source of funds. Mabhena said Standard Chartered Bank was in a better position to weather the cash crisis than many competitors, as it had many big

cash-generating customers. But he was concerned that some of those clients could begin to make more profitable use of their cash than by depositing it at the market's deeply negative real interest rates.

¶11. (C) Two days after the cash announcement, most of our banking sector contacts are not sure whether the changes will resolve the cash shortage. They see nothing in the proposed solutions to entice the public back to depositing their cash with formal financial institutions.

Comment

¶12. (C) Gono's latest measures fail to address the fundamental distortions in the economy that are driving the meltdown. His focus is on marginal issues and blaming others for the crisis. In reality, it is money creation by the RBZ

and not hoarding by "cash barons" that is bringing the economy to its knees. The unaccounted for amount of cash in circulation) Z$65 trillion out of Z$67 trillion, by Gono's reckoning and supposedly being hoarded) adds up roughly to Z$7 million per person, or the equivalent of just over one US dollar per person on the parallel market, and clearly too little to support the transactions demand for cash, even in a time of hyperinflation.

¶13. (C) Gono's hand at the wheel has failed to either choke the parallel markets or force transactions back into formal banking channels; the price control fiasco begun in June actually quickened the rate of informalization of the economy and drove prices out of reach of most Zimbabweans. Tax revenues also continue to swoon as the formal economy contracts. The RBZ's deeply concessionary lending has failed to re-stock supermarket shelves, and it has also robbed the commercial banks of their valuable corporate customers. For their part, the banks have been weakened by the increase in both reserve requirements and the accommodation rates, which has also reduced their ability to extend credit. They are seeking creative ways to stay afloat, minimize losses, and maintain their market presence through the thick of it. But confidence in an increasingly fragile banking sector has weakened further. Until the RBZ stops creating money, the exponentially increasing rate of inflation will remain unchecked. Gono's piecemeal reform measures offer no fundamental relief.
MCGEE